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TAGS: PGOV EPET EINV KZ
SUBJECT: KAZAKHSTAN: PROPOSED TAX CODE CHANGES COULD IMPACT OIL AND GAS SECTOR

REF: ASTANA 01910

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¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: In September, the Ministry of Finance submitted several proposed changes to the tax code to Parliament. If Parliament adopts the amendments, the changes will take effect January 1, 2009. A major objective of the new tax code is to increase tax revenues from the extractive industries. The new tax code would lower corporate income taxes, the crude oil rent tax, and the value added tax, while introducing new taxes for mineral extraction and excess profits. Business associations and investment advisors are concerned that the new tax code will undermine tax stability clauses in existing and future contracts. The government has said it will guarantee tax stability only for Tengizchevroil (TCO), which has a tax and royalty contract, and for existing production sharing agreements (PSAs), if the contracts are ratified by legislative acts of the Kazakhstani parliament. END SUMMARY.

¶3. (U) According to Tomas Balco, Senior Manager for PricewaterhouseCoopers, the government's stated objectives for amending the tax code include:

- reducing the tax burden for non-oil and gas industries;
- supporting economic diversification;
- curtailing the shadow economy;
- optimizing tax incentives;
- improving recovery of value-added tax (VAT) refunds; and
- increasing tax revenues from the extractive industries.

LOWER TAXES FOR CORPORATE INCOME, RENT, AND VALUE ADDED

¶4. (U) The new tax code would lower corporate income tax rates to 15% over a period of three years (to 20% in 2009, 17.5% in 2010, and

15% in 2011). The maximum rent tax on exported crude oil and gas condensate would be lowered to 32% (down from 33%) and this maximum rate would only apply if the price of oil is greater than $200 per barrel. Furthermore, companies subject to both the crude export customs duty and the rent tax would receive a tax credit so as to avoid double taxation. The VAT would decrease to 12% and geological exploration and prospecting operations would no longer be exempt.

NEW CORPORATE TAXES INTRODUCED

¶5. (U) A new mineral extraction tax would replace royalty payments in oil and gas contracts. Under the new tax code, the government will assess oil and gas condensate production at 7% to 20%, depending on annual volumes. The tax rate will be 50% lower for domestic sales of crude oil and gas condensate. The mineral extraction tax for natural gas will range from 0.5% to 1.5% and for minerals from 0.3% to 17%. The tax base for the mineral extraction tax will be the average world price of the relevant natural resource for the reporting quarter.

¶6. (U) The proposed new excess profits tax would likely hit extractive industries hardest. Companies with profits greater than 25% would have to pay an excess profits tax based on a progressive sliding scale, with a maximum tax rate of 60% applied to profits exceeding 70%.

CHANGES TO TAX STABILITY MAY AFFECT INVESTMENT CLIMATE

¶7. (SBU) The new draft tax code would supersede tax stability clauses for all contracts except Tengizchevroil's tax and royalty contract (TCO) and existing PSAs, provided those contracts are ratified by legislative acts of the Kazakhstani parliament. Almas Zhaiylgan, a lawyer in Almaty with the firm DentonWildeSapte, was skeptical that many investors would benefit from the government's guarantee. According to Zhaiylgan, "It is unclear why Parliament

must pass a separate law approving government contracts. This appears to be an attempt to eliminate tax stabilization for all but those very few contracts ratified by Parliament."

¶8. (SBU) PricewaterhouseCoopers' Balco, a lawyer and chartered accountant, said, "The proposed changes to tax stability are of great concern to the established investor community, both foreign and domestic, since this would be a significant policy change by the Government of Kazakhstan. The question is, will the Government honor its commitments or will it sacrifice tax stability and rattle investor confidence in order to meet short-term financial goals?"

¶9. (SBU) COMMENT. It is often necessary and even wise for a government to revise and update its tax code from time to time; that alone is no cause for concern to companies doing business in Kazakhstan. Indeed, the new tax code would actually lower many taxes, such as the corporate income tax, and rationalize several others. The real issue for investors -- here as elsewhere -- is the stability and predictability of the tax regime. Should the government take steps to undermine or challenge the tax stability clauses in TCO's contract or the Kashagan PSA, as it has done by imposing Kazakhstan's new crude export duty on the Karachaganak PSA, that would raise serious concerns. That said, Prime Minister Masimov has repeatedly reassured us that the government will respect contract sanctity. He has told us that he has personally advised the international oil companies to have their contracts ratified by parliament to provide legal certitude that their tax stabilization clauses will remain in effect and not be impacted by the new tax code. END COMMENT.

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